



NORTH CAROLINA

OFFICE OF THE TREASURER

JANET COWELL, TREASURER

November 8, 2012

Joint Legislative Commission
on Governmental Operations
North Carolina General Assembly
Raleigh, North Carolina 27601

Re: Quarterly report on Investment Funds for the period
ended September 30, 2012.

Commission Members:

Pursuant to G.S.147-68, we are providing a report on the investment activities of the State Treasurer. The report outlines investment activities in summary form for:

- The Cash Management Program – responsible for managing the operating funds of the State. The primary participants in this program are the State's General Fund and Highway Funds.
- The Trust Funds Investment Program – responsible for managing assets of the Teachers' and State Employees' Retirement System, the Consolidated Judicial Retirement System, the Firemen's and Rescue Squad Workers' Pension Fund, the Local Governmental Employees' Retirement System, the Legislative Retirement System, and the North Carolina National Guard Pension Fund. Collectively, these systems and funds are referred to as the North Carolina Retirement Systems or the Pension Fund. The Trust Funds Investment Program also includes other participants such as the State Health Plan, the Disability Income Plan, and the State Educational Assistance Authority.
- The Ancillary Investment Programs - as authorized by the General Assembly, responsible for managing assets for the Escheats Fund, Public Hospital Funds and the Local Government Other Post-Employment Benefits Fund.

Cash Management Program

The Cash Management Program, composed mostly of the Short-Term Investment Fund ("STIF"), produced a one year return of 0.43% for the participants. It also includes the Bond Proceeds Fund which is a separate investment account for each state bond issue to comply with Internal Revenue Service regulations on bond arbitrage.

Short Term Investment Fund

| <u>Historical T-Bill rates</u> | <u>9/30/11</u> | <u>3/31/12</u> | <u>9/30/12</u> |
|--------------------------------|----------------|----------------|----------------|
| 3-Mo. T-Bill | 0.023% | 0.066% | 0.094% |
| 6-Mo. T-Bill | 0.053% | 0.132% | 0.129% |

The Short-Term Investment Fund produced a one year return of 0.43% for the participants. The investable balances earning income for the General Fund were \$157 million higher than one year earlier based on book value. The investable balances, which earn income for the Highway Funds, were \$58 million higher than at the same time last year.

The investments held by the STIF on a particular date may be accruing income at different levels from current short-term interest rates. For example, if the investments were made when interest rates were lower, the earnings would continue to be at the lower rates of return, even though current interest rates may have moved higher. This happens in reverse as well.

The Bond Proceeds Fund is managed by a private investment company under contract with the Department of State Treasurer. The investments are valued at amortized cost, which approximates fair value.

Trust Funds Investment Program

The investment results for the Trust Funds Investment Program ("Trust Funds") are managed and reported on a cumulative total return basis. Total return includes realized income and the appreciation or depreciation of fair market value. Two funds comprise the vast majority of the Trust Funds assets. They are the Long-Term Investment Fund ("LTIF") and the Equity Investment Fund ("EIF").

| | <u>1 Year</u> | <u>2 Year</u> | <u>3 Year</u> | <u>5 Year</u> |
|----------------------|---------------|---------------|---------------|---------------|
| Total Trust Returns: | 13.87% | 8.25% | 8.65% | 3.09% |

Long Term Investment Fund

| | <u>1 Year</u> | <u>2 Year</u> | <u>3 Year</u> | <u>5 Year</u> |
|---------------|---------------|---------------|---------------|---------------|
| LTIF Returns: | 8.52% | 7.83% | 9.03% | 9.12% |

The below table provides a trend comparison of the current Treasury yields to the previous quarter.

| <u>US Treasury Yields</u> | <u>5 Year UST</u> | <u>10 Year UST</u> | <u>30 Year UST</u> |
|---------------------------|-------------------|--------------------|--------------------|
| As of 6/30/12 | 0.72% | 1.65% | 2.75% |
| As of 9/30/12 | 0.63% | 1.63% | 2.82% |

- Long Term assets (based on market value) ended the quarter approximately \$413 million higher than at the end of the prior reporting period.
- The realized earnings for the fiscal year to date are \$352 million.
- Approximately \$319 million was used to pay benefits or was reallocated to other investment funds this quarter.

Equity Investment Fund

| | <u>1 Year</u> | <u>2 Year</u> | <u>3 Year</u> | <u>5 Year</u> |
|--------------|---------------|---------------|---------------|---------------|
| EIF Returns: | 22.39% | 7.85% | 8.50% | -0.53% |

The below table provides third quarter equity market returns as measured by major indices.

| | | | | |
|--------------------------|--------------|-------|-----------|-------|
| Quarterly Index Returns: | S&P 500 | 6.35% | DJIA | 4.32% |
| | Russell 3000 | 6.23% | MSCI EAFE | 6.92% |

- Assets of the fund (based on market value) ended the quarter approximately \$2.10 billion higher than at the end of the prior reporting period.
- Approximately \$100 million was used to pay benefits or was reallocated to other investment funds this quarter.

Pursuant to Session Law 2009-98 and G.S.147-69.2, the Treasurer is now authorized to invest in credit and inflation-linked strategies. These new classifications are reflected in the attached report.

Ancillary Investment Programs

The Ancillary Investment Programs, as authorized by the General Assembly, are responsible for managing assets for the Escheats Fund, Public Hospital Funds, the Local Government Other Post-Employment Benefits Fund and the Conservation Easement Endowment Fund.

Pursuant to G.S. 116-37, deposits are held for the Watauga Medical Center, New Hanover Memorial Hospital, Margaret R. Pardee Hospital, and Columbus Regional Healthcare System, all subject to compliance with G.S. 147-69.2. The assets are allocated as follows: STIF, LTIF and authorized Equity funds. For the quarter ending September 30, 2012, the invested assets were valued at \$77.8 million after returns in the domestic and international accounts of 6.14% and 8.04% respectively.

Pursuant to G.S. 147-69.2(b)(12), up to 20% of the Escheat Fund's assets can be invested in authorized Equity, Real Estate, and Alternative Investments. For the quarter ending September 30, 2012, \$40 million has been invested in equity, of which \$40.8 million has been received in distributions; \$20 million has been invested in real estate, of which \$16.5 million has been returned; and commitments totaling \$57 million have been made to private equity, of which \$50.8 million has been contributed.

Pursuant to G.S. 159-30.1, 147-69.2(a)(17g), and 147-69.2(b4), deposits are held for the Local Government Other Post-Employment Benefits Fund. The assets are allocated as follows: STIF, LTIF, and authorized Equity funds. For the quarter ending September 30, 2012, the externally invested assets were valued at \$61.5 million after returns in the domestic and international equity accounts of 6.14% and 8.04% respectively.

Other Reporting Requirements

Pursuant to Session Law 2007-323 Sec. 13.2.(b), G.S. 147-68(d1), the Treasurer "shall include a specific listing of all investments made with certified green managers and companies and funds that support sustainable practices, including the names of the companies, managers, and funds, the amount invested, and the State's return on investment." Based on currently available research, there is no validation group or process that certifies green managers for investments, and the statute provides no definition of the term "sustainable practices" that would enable the Treasurer to determine which companies and funds would fall under this provision. Thus, it is not possible to report any relevant data at this time.

Thank you for your attention. Please feel free to contact the Department of State Treasurer if you have any questions.

Sincerely,

A handwritten signature in cursive script that reads "Janet Cowell". The signature is written in dark ink and is positioned above the printed name.

Janet Cowell

Attachments

cc: Bryan Lewis, Interim Chief Investment Officer
Fran Lawrence, Chief Financial Officer